No. 82-1066

In the
Supreme Court of the United States

October Term, 1982

UNITED STATES OF AMERICA,

Appellant,

v.

HARRY PTASYNSKI, et al.,

Appellees.

On Appeal From The United States District Court For The District Of Wyoming

---

BRIEF AMICI CURIAE OF AMERICAN FARM BUREAU FEDERATION, WYOMING FARM BUREAU FEDERATION AND TEXAS FARM BUREAU IN SUPPORT OF APPELLEES

JOHN J. RADEMACHER*
General Counsel

RICHARD L. KRAUSE
Assistant Counsel

AMERICAN FARM BUREAU FEDERATION
225 Touhy Avenue
Park Ridge, IL 60068
(312) 399-5788

Attorneys for Amici Curiae

*Counsel of Record

UNITED STATES LAW PRINTING CO., CHICAGO, ILLINOIS [illegible] (312) [illegible]

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitution, Statutes, Regulations

Miscellaneous

PAGE

127 *Cong. Rec.*:

p. S.9182 (Daily Ed. Aug. 3, 1981) 7

H.R. Conference Report, No. 96-817, 96th Cong., 2d Sess. (1980) 17, 19

Senate Report No. 97-144, 97th Cong., 1st Sess. (1981) 9

Small Royalty Owners Exemption From the Windfall Profit Tax: Hearings on S.2521 before the Subcommittee on Taxation and Debt Management Generally of the Senate Committee on Finance, 96th Cong., 2d Sess. (1980) 7, 8, 9

In the
Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-1066

UNITED STATES OF AMERICA,

Appellant,

v.

HARRY PTASYNSKI, et al.,

Appellees.

On Appeal From The United States District Court For The District Of Wyoming

---

BRIEF AMICI CURIAE OF AMERICAN FARM BUREAU FEDERATION, WYOMING FARM BUREAU FEDERATION AND TEXAS FARM BUREAU IN SUPPORT OF APPELLEES

The American Farm Bureau Federation, Wyoming Farm Bureau Federation and Texas Farm Bureau respectfully submit this brief *amici curiae*. Pursuant to Supreme Court Rule 36, this brief is filed with the written consent of the parties.

INTEREST OF AMICI CURIAE

The American Farm Bureau Federation of 225 Touhy Avenue, Park Ridge, Illinois is a general farm organization organized in 1919 under the "General Not-For-Profit Corporation Act" of the State of Illinois. It has as its purposes the promotion, protection and representation of

the business, economic, social and educational interests of the farmers and ranchers in the United States. It has member State Farm Bureau organizations in 48 states and Puerto Rico, representing the interests of more than 3 million member families.

The Texas Farm Bureau is a member of the American Farm Bureau Federation and represents the interests of more than 306,000 member families in the State of Texas.

Wyoming Farm Bureau Federation is a member of the American Farm Bureau Federation and represents the interests of more than 8,000 member families in Wyoming.

Imposition of the so-called "windfall profit tax" has serious adverse repercussions on farmers and ranchers throughout the United States, because of its application to landowners (many of whom are Farm Bureau members) who own royalty interests in wells on their property.

Virtually forgotten during the debates on the windfall profit tax, royalty owners became unwitting subjects of the tax. The windfall profit tax was intended to minimize the passing of billions of dollars into oil company coffers as a result of crude oil price deregulation. Yet royalty owners, many of them struggling to make ends meet, found themselves taxed at the same high rate as Exxon, Standard Oil, and other major oil companies. Unlike large oil companies however, these small royalty owners are unable to pass the tax along or to minimize its effect by offsetting it against other investments. Moreover, as consumers, royalty owners are directly affected by supply and/or price variations that might be caused by the windfall profit tax.

The "economic interest" of royalty holders is different than the "economic interest" of the oil producers for whom the tax was intended. From a legal standpoint, the nature of the tax imposed on royalty interests is different

than the tax imposed on producer interests. This difference between "royalty interest" and "producer interest" is also relevant in evaluating whether there is a "rational basis" to support the Alaskan exemption.[1]

Because of these differences, the windfall profit tax should be reviewed in two separate contexts—as levied against producer interests and as levied against royalty interests. But both viewpoints are necessary for a consideration of the tax as a whole.

It is our intention to provide the viewpoint of the royalty holders. The interests of royalty holders were ignored during enactment of the windfall profit tax; they should not be overlooked upon its review.

SUMMARY OF ARGUMENT

Title I of the Crude Oil Windfall Profit Tax Act of 1980 imposes a complicated excise tax on the removal and sale of domestically produced oil. The measure of the tax is the so-called "windfall profit" resulting from price decontrols.

Major targets of the tax were large oil companies who stood to reap increased revenues as a result of oil price decontrol. However, small royalty owners were also caught as unintended victims of the tax, subject to the same high tax rates as the large oil companies. The confusion appears to have been caused by the Act's definition of "producer," which has a broad meaning based upon federal income tax purposes instead of being defined for the speci-

[1] We hereby decline the invitation of the government to use the terms "North Slope exemption" or "Arctic exemption," preferring instead to employ the term used by Congress. Using the same terminology employed by Congress is more accurate and more indicative of Congressional intent.

fic excise at issue. Congress sought to solve this problem by a "band-aid" series of credits and exemptions for royalty interests, without addressing the real issue of whether royalty interests should have been taxed in the first place.

Royalty owners are not engaged in the production of oil. Rather, their "interest" derives from their giving up their interests in oil on their land. They receive compensation for granting this interest in the land, and the value of the interest is determined in part by the price of oil and the amount of oil taken from the land. For tax purposes, these payments have been construed as rents or income from the land, and not as interests in oil. Because the windfall profit tax imposes a levy on interests in oil, royalty holders are therefore outside the scope of the tax.

The specific exemption of certain Alaskan oil from taxation of "newly discovered oil" violates the requirement of geographic uniformity pursuant to Article I, Section 8, Clause 1 of the United States Constitution. The government seeks to justify the exemption on the basis that production costs for extracting this oil are extremely high, and that all producers are thus treated alike regardless of geographic location.

This justification is incorrect. Royalty owners do not share in the costs of oil production, and therefore the location of oil has no relevance with regard to them. Royalty owners in the lower 48 states are subject to tax on the increase in value of the property interest granted to their producers, while royalty owners in exempt Alaskan oil are not. Not only is the windfall profit tax not "geographically uniform" as applied to royalty interests, but there is no basis, rational or otherwise, for any different tax treatment.

ARGUMENT

I.

ROYALTY INTERESTS WERE NOT INTENDED TO BE SUBJECT TO WINDFALL PROFIT TAXATION.

a) Windfall Profit Tax

Title I of the Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223) created a complex tax on the production of domestic crude oil. A purpose of the tax was to prevent large oil companies from reaping excessive profits from the decontrol of domestic oil prices.

The tax is imposed on the removal and sale of domestically produced crude oil. The measure of the tax is the "windfall profit" from such oil (26 U.S.C. §4986), which is defined as the difference between the "removal price" (essentially decontrolled oil) and an "adjusted base price" (essentially controlled oil). The Act presents a complicated maze of tax rates which vary according to whether oil is classified as tier 1, tier 2 or tier 3; whether it is produced by large oil companies or independent producers; and whether it comes from Alaska or from the other 49 states.

The windfall profit tax was intended to raise large sums of revenue for the government, and the dollar amounts at stake are thus considerable.[2] The windfall profit tax was also part of a plan to increase production of domestic

[2] Of course, the financial stakes are not relevant to a determination whether the tax violates the United States Constitution, and this factor should have no part in this Court's review of the issues raised herein.

crude oil, which was the underlying purpose of the "Alaskan exemption."

The tax on the so-called "windfall profit" is to be paid by the "producer" of the oil [26 U.S.C. §4986(b)]. In a tax bill of such complexity and detail, the definition of "producer" stands out as being particularly ill-conceived and carelessly drawn. A "producer," for windfall profit tax purposes, is anyone who has an "economic interest" in the oil as defined for federal *income tax* purposes,[3] and includes large oil companies, independent producers, oil investors, and royalty owners.

However, the "economic interest" in oil that is subject to federal income taxation is not the same as the "windfall profits" interest subject to the windfall profit tax. The nature and extent of federal income taxation is more far-reaching than the nature and extent of federal windfall profit excise taxation. (U.S. Const. amend. XVI; *Pollock v. Farmers' Loan and Trust Company,* 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759 (1895); *Brushaber v. Union Pacific Railroad,* 240 U.S. 1, 36 S.Ct. 236, 60 L.Ed. 493 (1916). The Sixteenth Amendment to the United States Constitution was specifically adopted to provide for taxation of "income" that could not be reached through "excises" such as the windfall profit tax, *Brushaber v. Union Pacific Railroad,* supra.

b) Inclusion Of Royalty Holders In The Windfall Profit Tax.

Royalty owners are landowners whose property contains the crude oil that is produced. They derive their "royalty interest" from payments by oil producers given in exchange for the privilege of being able to come onto

---

[3] 26 U.S.C. §4996(a)(1)(A) and 26 CFR 150.4996-1(b)(1).

the property and drill for oil and for the exclusive rights to any oil so produced. Royalty owners generally have no control over how much oil is produced from their property, the manner in which it is produced, or the price at which it is sold.

It is estimated that there are more than two million royalty owners in the United States. A profile of the average royalty owner that emerged from field hearings on a bill to exempt small royalty owners from the tax[4] is in stark contrast to the giant oil companies at whom the tax was aimed.

Many of the royalty owners are farmers and ranchers who own the land upon which oil is produced. The vast majority of these people receive small incomes from royalties, many less than $100 per month.[5] Nevertheless, most royalty owners rely heavily on this small royalty income either to help defray the large operating expenses necessary to farm (especially in these times of depressed farm prices), or to plan for retirement. A significant number of royalty owners are already retired, and depend upon their royalty income for survival.[6]

For example, an analysis by West Texas Land and Royalty Owners Association of the royalty interests in

---

[4] See *Royalty Owners Exemption From the Windfall Profit Tax: Hearings on S.2521 before the Subcommittee on Taxation and Debt Management Generally of the Senate Committee on Finance*, 96th Cong. 2d Sess. (1980).

[5] Id., at page 299 (Statement of Senator David Boren).

[6] Of the more than 4,000 who attended the field hearings, over 50% identified themselves as being retired, and 75-80% identified themselves as farmers. 127 Cong. Rec. S.9182 (Aug. 3, 1981) (Remarks of Sen. Dole).

the nation's largest unitized oil field produced the following results: in 97% of the property included, royalty interests were held by the farmer-landowner. The average size of the farms in the field was 140 acres. 78% of the royalty owners received less than $100 per month, and only 8% received more than $500 per month. Another survey conducted by the Association found that over 50% of royalty holders in the southwestern United States are over 65, and over 65% are over 60.[7]

The hearing record is replete with testimony and letters from such people. The windfall profit tax took as much as 30% or 40% of their total royalty checks, often resulting in extreme financial hardship.

c) Subsequent Legislation

It soon became evident to Congressional leaders that they had completely overlooked the impact of the windfall profit tax on royalty owners. This realization is graphically illustrated in an exchange on the Senate floor between Senator Dole of Kansas (the ranking Republican on the Senate Finance Committee which heard the bill) and Senator Russell Long of Louisiana (the Chairman of the Senate Finance Committee).[8] Senator Dole acknowledged that during debates on the bill in Committee and in Conference "the focus was almost entirely on oil producers, whether they were independent producers or major

---

[7] *Small Royalty Owners Exemption From the Windfall Profit Tax: Hearings on s. 2521 before the Subcommittee on Taxation and Debt Management Generally of the Senate Committee on Finance*, p. 346 (Statement of the West Texas Land and Royalty Owners Association).

[8] 126 Cong. Rec. S.3054-5 (March 26, 1980). Excerpts from that discussion are attached hereto as Appendix A.

companies,'"[9] and that royalty owners were not considered at all. Senator Long stated that by the time the bill was considered in Conference it was too late to remedy the situation, saying that "we did not have the language in conference that would make it possible for us to do for the benefit of royalty owners what I would like to have done.'"[10]

On the same day the windfall profit tax was signed by President Carter, Senator Dole introduced a bill (S.2521) to exempt small royalty owners from the tax. Senator Dole stated: "They were not the intended target of the windfall profit tax when it was first proposed, when it passed the Senate Finance Committee, or when it originally passed the Senate.'"[11]

In lieu of S.2521, a provision was hastily added in the Omnibus Reconciliation Act of 1980 (P.L. 96-499) giving royalty owners a tax credit of $1,000 against their windfall profit tax liability for 1980.

The Economic Recovery Tax Act of 1981 (P.L. 97-34) increased the tax credit to $2,500 for 1981. For subsequent years, the tax credit was replaced with an exemption from windfall profit tax on up to two barrels per day for 1982 through 1984, and up to three barrels par day for 1985 and thereafter. This action was taken because "imposition of the windfall profit tax on small amounts of royalty oil income may impose a hardship on many low and middle income taxpayers who are not recipients of the large oil company profits which lead, in part, to the windfall profit tax.'"[12]

---

[9] Id.

[10] Id.

[11] See 126 Cong. Rec. S.3438 (April 2, 1980).

[12] *Senate Report* No. 97-144, p. 93.

These subsequent amendments temporarily alleviate some of the financial burdens of the windfall profit tax on royalty owners. However, because it was concerned with lessening the tax impact on royalty owners, Congress did not focus on the substantive differences between royalty interests and producer interests, and whether royalty owners were even proper subjects of windfall profit taxation at all.

Moreover, by merely reducing the taxation of royalty interests, Congress did not relinquish jurisdiction over them, and could still raise the tax on royalty interests to original levels or higher to suit revenue needs. Finally, these subsequent amendments provide little or no relief to windfall profit taxes paid on royalty interests prior to the enactment of these amendments.

II.

THE "ROYALTY INTEREST" DIFFERS FROM OTHER "ECONOMIC INTERESTS IN OIL."

Royalty owners are not engaged in the production of oil. They are landowners whose property contains the crude oil that is produced and refined. The royalty interest derives from an "oil and gas lease" between the landowner and a drilling company or other oil producer desirous of extracting oil from the property.

Pursuant to the lease, the landowner ("lessor") grants to the producer ("lessee") the right to enter the premises and to drill for and produce any oil found therein. The landowner further relinquishes any right, title or interest in any oil on his property in favor of the lessee. In exchange for the right to the oil and to enter upon the premises, the driller agrees to pay certain compensation to the landowner. Often the amount of compensation (which is

the value of the interest granted) is determined as a percentage of the value of the oil extracted. Compensation determined on this basis is called a "royalty."

Once the lease has been executed,[13] the landowner has no right to produce or control production of oil from his property, and is not involved with the actual production of the oil.

The royalty interest of the farmer and other landowners is therefore different than the "economic interests" of those engaged in actual oil production in a very fundamental respect. The "royalty interest" is derived from an interest in real property rather than from an interest in oil. In fact, the royalty interest arises from a landowner giving up any interest in the oil.

Royalty income is compensation for the granting of a real property interest, and not the reservation of an interest in oil. It is therefore in the nature of rent and income from real property, not in the nature of profit from the sale of oil. The significance of this distinction has important ramifications not only for federal windfall profit taxation but also for federal income tax purposes.

If "royalty income" derives from an "interest in oil" such income should be treated as the sale or disposition of a capital asset entitled to capital gains treatment. If, on the other hand, the royalty interest is "rents" or "income" from real property, it would be ordinary income.

The Court has addressed this issue on numerous occasions. In each case, the "royalty interest" has been held to be income from real property subject to ordinary in-

[13] Oil and gas leases are generally recordable in the Recorder's Office in the manner provided for recordation of real property interests.

come treatment rather than an interest in oil. *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 37 S.Ct. 201, 61 L.Ed. 460 (1917); *Lake Superior Mines* v. *Lord*, 271 U.S. 577, 46 S.Ct. 627, 70 L.Ed. 1093 (1926); *Burnet* v. *Harmel*, 287 U.S. 103, 53 S.Ct. 74, 77 L.Ed. 199 (1932); *United States* v. *Biwabik Mining Company*, 247 U.S. 116, 38 S.Ct. 462, 62 L.Ed. 1017 (1918).

In *Von Baumbach* the Court stated that "the payments made by the lessees to the corporation now before the court were not in substance the proceeds of an outright sale of mining property, but in view of the terms of these instruments, were in fact rents or royalties to be paid upon entering into the premises and discovering, developing and removing the mineral resources thereof . . ."[14]

In *Burnet*, the Court found that "the payments made by the lessee are consideration for the right which he acquired to enter upon and use the land for the purpose of exploiting it, as well as for the ownership of the oil and gas . . ."[15] As a result, the Court concluded that "payments by lessees to lessors under mining leases were not a conversion of capital, as upon a sale of capital assets, but were income to the lessor, like payments of rent."[16]

In *Biwabik Mining*, the Court held that oil and gas leases "were not conveyances of the ore in place, but were grants of the privilege of entering upon, discovering, and developing and removing the minerals from the land."[17]

Whether royalty payments are made in kind rather than in cash does not alter the character of payment as "in-

---

[14] 241 U.S. 521-2.

[15] 287 U.S. 111.

[16] 287 U.S. 108.

[17] 247 U.S. 123.

come." *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599, 66 S.Ct. 409, 90 L.Ed. 343 (1946); *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25, 66 S.Ct. 861, 90 L.Ed. 1062 (1946).

Royalty income is income from a real property interest, similar to rent. The value of this interest happens to be determined by the price of oil. Because the royalty interest is not an interest in oil, the royalty owner can have no interest in the "windfall profits" from such oil, and therefore cannot be held liable for payment of taxes thereon.

This Court's decisions holding that royalty income is rent or income from property rather than from an interest in oil already works a hardship on royalty owner taxpayers by not permitting them the more beneficial capital gains treatment. Royalty owners should not now be subject to an additional hardship based upon the opposite interpretation.[18] If subject to windfall profit taxation, royalty owners would have the worst of both worlds.

---

[18] In this regard, American and Wyoming Farm Bureau Federations also argued *amici curiae* in the lower court that a tax on royalty interests was a tax on a real property interests and therefore more in the nature of a "direct" tax than an "excise" tax. *Pollock* v. *Farmer's Loan and Trust Company*, supra, and its progeny. (See generally Brief of Amici Curiae at Vol. II, pp. 479-515 of the Record on Appeal.) We do not wish to obscure the importance of the uniformity issue raised herein and therefore we have not reiterated our argument on the direct tax issue before this Court. However, if the Court were to reverse the lower court on either of the questions presented, we respectfully suggest that this Court might remand the direct tax issue to the lower court for full consideration.

III.

THE WINDFALL PROFIT TAX IS NOT "UNIFORM THROUGHOUT THE UNITED STATES" AS REQUIRED BY THE CONSTITUTION OF THE UNITED STATES.

Farm Bureau submits that the district court correctly held that Title I of the Crude Oil Windfall Profit Tax Act of 1980 violated the Uniformity Clause of Article I, Section 8, Clause 1 of the United States Constitution. We further submit that the district court was correct in declaring the entire Title unconstitutional rather than severing the offending provision.

We believe that the position of Appellees and Intervenors on these issues is the correct one and we support and adopt their arguments in our brief. To avoid repetition these arguments will not be fully briefed herein.

a) The Uniformity Clause Requires That "Subjects" Of Excise Taxation Be Taxed At The Same Rate Wherever They Exist Throughout The United States.

The rule of uniformity for purposes of excise taxation, set forth in Article I, Section 8, Clause 1 of the Constitution of the United States, was explained in the *Head Money Cases,* 112 U.S. 580, 5 S.Ct. 247, 28 L.Ed. 798 (1884). The Court stated that an excise is "uniform" if "it operates with the same force and effect in every place where the subject of it is found."[10] This rule was re-affirmed in *Knowlton* v. *Moore,* 178 U.S. 41, 84, 20 S.Ct. 747 (1900), where the Court, after a comprehensive review of the Uniformity Clause, declared that "wherever a subject is taxed anywhere, the same must be taxed everywhere throughout the United States, and at the same rate."

---

[10] 112 U.S. at 594.

This clear statement of "geographical uniformity" is the test applicable in the present case.

Nevertheless, the government cites the *Head Money Cases* and the *Regional Railroad Reorganization Act Cases,* 419 U.S. 102, 95 S.Ct. 335, 42 L.Ed.2d 320 (1974) in support of an argument that Congress may take geographical considerations into account in applying an excise tax. The *Regional Railroad Reorganization Act Cases* noted that the Uniformity Clause "does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems."[20]

A careful reading of these and other cases does not, as the government contends, lead to the conclusion that Congress can apply excise taxes at different rates in different parts of the country. Rather, the "power" referred to is the "power" to *define* subjects of excise taxation in such a way as to achieve desired goals.

Congress has plenary authority over matters of federal taxation, subject only to the constitutional qualifications that direct taxes must be apportioned and excise taxes must be uniform throughout the United States, *The License Tax Cases,* 72 U.S. (5 Wall.) 462 (1867); *Pacific Insurance Co.* v. *Soule,* 7 Wall. 433, 19 L.Ed. 244 (1868); *McCray* v. *United States,* 195 U.S. 27, 24 S.Ct. 769, 49 L.Ed. 78 (1904). This plenary power over taxation includes the power to define subjects for taxation. Congress may define subjects of taxation as broadly or as narrowly as it desires. Subjects of excise taxation can be defined so narrowly as to exist in only one region of the country. But, once defined, a subject of excise taxation must be taxed at the same rate wherever it exists in the United States.

---

[20] 419 U.S. 159.

In the *Head Money Cases*, an excise was levied on "all ports" of the United States. The tax classification was defined to include only coastal ports and to exclude inland cities and transportation terminals. The tax was designed to "take into account differences that exist between different parts of the country." Nevertheless, all U.S. "ports," as defined in the Act, were subject to the same tax at the same rate.

Likewise, in the *Regional Railroad Reorganization Act Cases*,[21] Congress selected as subjects for relief all railroads then under reorganization, even though all such railroads were located in one region of the country. The tax was designed to "resolve geographically isolated problems." Nevertheless, the law applied to all railroads throughout the United States then in reorganization, and was therefore "uniform throughout the United States."

In each case Congress exercised its legislative prerogative to define its subject classification in such a way to address certain specific problems. However, a common thread throughout these and other cases is that *the tax or relief was applied to every subject of the classification as defined by the tax, regardless of its location.* To this extent, the tax "operates with the same force and effect in every place where the subject of it is found," and is therefore "uniform throughout the United States."

Such is not true in the present case. One of the classifications of taxation under the Windfall Profit Tax is "newly discovered oil," which is generally defined as oil from

---

[21] While the *Rail Reorganization* case construed the uniformity provision of the Bankruptcy Clause, the Court stated that its construction was the same as its construction of the Uniformity Clause applicable to excise taxes (95 S.Ct. at 367).

property which there was no production in 1978.[22] However, the tax is not imposed on all "newly discovered oil" at the same rate wherever it exists in the United States, because certain "newly discovered oil" in Alaska is not taxed at all. The tax is therefore not "uniform throughout the United States" as required by the Constitution.

This Court's recent decision in *Railway Labor Executives' Association* v. *Gibbons*, ... U.S. ...., 102 S.Ct. 1169 (1982) illustrates this principle and clarifies the holding of the *Regional Railroad Reorganization Act Cases.* Although construing the Bankruptcy Clause, *Gibbons* is similar in many respects to the present case.[23]

The Court held the statute at issue (RITA) unconstitutional while at the same time re-affirming its statements in the *Regional Railroad Reorganization Act Cases.* The distinguishing factor cited by the Court is that the *Regional Railroad Reorganization Act* applied to *all* railroads then in reorganization, even though they were in one geographic area. RITA, on the other hand, applied to one specific railroad without regard to whether there were other railroads then under reorganization. In reconciling the principle of these two cases, the Court stated:

> "Our holding today does not impair Congress' ability under the Bankruptcy Clause to define classes of debtors and to structure relief accordingly. We have upheld bankruptcy laws that apply to a particular industry in a particular region. See *3 R Act Cases,* supra. The Uniformity requirement, however, prohibits

---

[22] 26 U.S.C. §4991(e)(2) and *House Conference Report* No. 96-817, p. 97.

[23] The similarity extends to the fact that *Gibbons* represents the first bankruptcy law stricken on uniformity grounds. (102 S.Ct. 1176). So also, the government in this case states that the windfall profit tax is the first tax statute stricken on uniformity grounds. (J.S., p. 14).

> Congress from enacting a bankruptcy law that, by definition, applies only to one regional debtor. *To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors.*'' (Emphasis added).[24]

So too, because the Alaskan exemption gives relief to one specific location of ''newly discovered oil'' without regard for other possible locations of ''newly discovered oil,'' the statute must be declared unconstitutional.

The government's suggestion that Congress could have accomplished the same result by defining taxable oil in terms of weather conditions and nearness to transportation merely reinforces this conclusion. Had Congress defined taxable oil in those terms it would have exercised its legislative prerogative to narrow the definition of oil subject to taxation, and all oil throughout the United States meeting that definition would have been taxed alike. But that is not what Congress did. Congress chose instead to define ''newly discovered oil'' in general terms and then exempt certain ''newly discovered oil'' on the basis of geographical location. The result is a violation of the Uniformity Clause.

b) The "Rational Basis" Argument Is Nothing More Than Intrinsic Uniformity.

The government contends that:

> ''all oil producers who are similarly situated with respect to the purposes of the Windfall Profit Tax are treated alike regardless of their geographic location. This is the only uniformity the Constitution requires.'' (Brief for the United States, p. 10)

The argument is that Congress had a ''rational basis'' for excluding Alaskan oil because of its hardship on producers

---

[24] 102 S.Ct. 1178.

and possible disincentives of such producers to develop Alaskan oil.

The argument focuses on the effects of the windfall profit tax on oil producers. As such, it is nothing more than a warmed-over version of the "intrinsic uniformity" argument specifically rejected by this Court in *Knowlton* v. *Moore,* supra.

The distinction between "intrinsic" and "geographic" uniformity is the focus of the uniformity sought to be achieved. "Geographic uniformity" focuses on the subject matter of the tax, for taxation of the subject at the same rate wherever it is located throughout the United States without regard to its effect on taxpayers. "Intrinsic uniformity," on the other hand, focuses on the effects of the tax on the taxpayers, lessening taxation of the subject matter in a particular location if it would have a particularly onerous effect on the taxpayer. (See *Knowlton* v. *Moore,* 178 U.S. at 84).

The Conference Report of the Windfall Profit Tax Act stated that the Alaskan exemption "reflects the concern of the conferees that taxation of this production would discourage exploration and development of reservoirs in areas of extreme climatic conditions."[25]

The concern of the conferees was that producers of Alaskan oil would bear a disproportionate burden if the windfall profit tax were applied to Alaskan oil. By seeking to equalize the impact of the tax on producers of Alaskan and other oil, Congress was focusing on the taxpayer rather than the subject matter of the tax.

We submit that this is therefore no different than the "intrinsic uniformity" standard defined, and rejected, in *Knowlton* v. *Moore.*

---

[25] *House Conference Report* No. 96-817, p. 103.

IV.

THERE IS NO "RATIONAL BASIS" FOR THE ALASKAN EXEMPTION WITH RESPECT TO WINDFALL PROFIT TAXATION OF ROYALTY OWNERS.

The gist of the government's argument in support of the Alaskan exemption is that there was a "rational basis" for excluding this oil.

Leading cases construing the Uniformity Clause clearly indicate that the "rational basis" test has no application with regard to the "uniformity" requirement for excise tax purposes. *The Head Money Cases*, supra; *Knowlton* v. *Moore*, supra. The only "uniformity" required is that all subjects of an excise be taxed at the same rate wherever found in the United States.

Nevertheless, even if the "rational basis" test were applicable to the uniformity clause, there is no rational basis for the Alaskan exemption as it is applied to royalty owners.

a) The Windfall Profit Tax Is Not Levied On "Profits" From Oil Production.

The government contends that the rationale for the Alaskan exemption is that any "windfall profit" received from production of Alaskan oil would be more than offset by higher production costs inherent in extracting that oil. As stated in their brief:

> "Moreover, Congress recognized that it was even more difficult to identify an element of 'windfall profit' appropriate for taxation in the case of 'North Slope' oil. Such oil was subject to extraordinary transportation costs, which served to reduce the wellhead price (and hence gross revenues) by $6-8 per barrel, and extraordinarily high exploration and development costs,

> which were estimated at several times the cost of domestic exploration and development elsewhere." (Brief of United States, p. 9).

Implicit in this line of reasoning is the assumption that production expenses are taken into account when determining the "profits" subject to windfall profit tax.

This, however, is not how "windfall profit" is defined in the Act. Section 4988(a) of the Internal Revenue Code [26 U.S.C. §4988(a)] defines "windfall profit" as:

> "the excess of the removal price of the barrel of crude oil over the sum of—
>
> (1) the adjusted base price of such barrel, and
>
> (2) the amount of the severance tax adjustment with respect to such barrel provided by section 4996(c)."

"Removal price" is "the amount for which the barrel is sold." [26 U.S.C. §4988(c)(1)]. "Adjusted base price" is generally the price of oil in 1979, either under "controlled" or "uncontrolled" circumstances depending upon the tier classification. [26 U.S.C. §4989(a)].

Thus, "windfall profit" subject to taxation is essentially the difference between the present, uncontrolled price of oil and the price of oil as it was in 1979. It is based on increased "gross revenues" and not on an increase in "net profits." There is no provision in the Act to permit taking production costs into account in determining "windfall profit" subject to the tax.

Increased expenses for production of Alaskan oil therefore offers no basis for stating that there is no "windfall profit" on such oil. Without this, the rationale for the Alaskan oil disappears.

b) There Is No "Rational Basis" For The Disparity In Tax Treatment Of Royalty Owners.

The windfall profit tax that is levied upon royalty interests is not "uniform throughout the United States," as required by the Constitution of the United States, for the reasons set forth above and in the briefs of Appellees. Moreover, there is no "rational basis" for exempting "Alaskan oil" royalty interests from windfall profit taxation.

Royalty owners are not required to share in production or exploration costs of oil removed from their property. Therefore, the argument advanced by the government regarding increased exploration and production costs of Alaskan oil has no application to the windfall profit taxation of royalty interests.

Because the value of the real property interest granted to working producers is arbitrarily pegged at the price of oil, income received from royalty interests will vary according to the price of oil. This is true whether one lives within the boundaries of the Alaskan exemption or not. Presumably, the value of that real property interest will increase as a result of price decontrol. Royalty interests outside the Alaskan exemption are subject to windfall profit txation of this increased value; royalty interests within the Alaskan exemption are not.

It cannot be argued that since "working interests" in Alaskan oil are exempt from tax, it automatically follows that corresponding royalty interests must also be exempt. While the Act does not specifically address this issue with regard to exempt Alaskan oil, the Act does recognize a difference in tax treatment between "working interests" and "royalty interests."

The Act provides for special tax rates on a limited amount of oil know as "independent producer oil." (26

U.S.C. §4992). For "independent producer oil" of up to 1,000 barrels per day, tier 1 oil is taxed at 50% (instead of 70%) and tier 2 oil is taxed at 30% (instead of 60%). The rationale for the difference in tax treatment is to encourage domestic production by not deterring producers from incurring possibly greater production costs. Royalty interests are specifically excluded from the definition of "independent producers" because they do not share in these costs, and do not receive the benefits of lower tax rates.

The rationale for the independent producer exemption was essentially the same as that for the Alaskan exemption. The independent producer exemption, rightly or wrongly,[26] recognized a difference in working interests and royalty interests sufficient to warrant different tax treatment. Moreover, such differences were based on factors nearly identical to those considered in formulating the "Alaskan exemption."

It is thus apparent that windfall profit taxation of royalty interests is not geographically uniform throughout the entire United States. Nor is there any "rational basis" or any other reason advanced for this disparity. We submit that the Court should hold that windfall profit taxation of royalty interests is unconstitutional because it is not uniform throughout the United States as required by Article I, Section 8, Clause 1 of the Constitution of the United States.

---

[26] We make no statement whether Congress was correct in treating royalty interests different than working interests for purposes of the independent producer classification. It is mentioned only to show that Congress treated them differently in circumstances similar to the Alaskan exemption.

CONCLUSION

The lower court correctly interpreted and applied the "geographic uniformity" requirement of Article I, Section 8, Clause 1 of the United States Constitution in holding that the windfall profit tax was unconstitutional. Moreover, the court correctly refrained from "judicial legislation" in declaring all of Title I unconstitutional rather than severing the offending provision.

For these reasons, and the reasons set forth in this brief, the judgment of the lower court should be affirmed.

Respectfully submitted,

JOHN J. RADEMACHER*
General Counsel

RICHARD L. KRAUSE
Assistant Counsel

AMERICAN FARM BUREAU FEDERATION
225 Touhy Avenue
Park Ridge, IL 60068
312/399-5795

Attorneys for Amici Curiae

* Counsel of Record

APPENDIX A

EXCERPTS OF REMARKS REGARDING WINDFALL TAXATION OF ROYALTY HOLDERS

(126 Cong. Rec. S. 3054-5, March 26, 1980)

MR. DOLE. Second, when we debated the windfall profit tax in the Finance Committee, on the Senate floor, and even during conference, the focus was almost entirely on oil producers, whether they were independent producers or major companies. Nevertheless, as I stated previously, the conference report would impose a windfall profit tax not just on oil producers but also on countless numbers of royalty owers. At least in Kansas, these royalty owners are not generally wealthy individuals. They are farmers, scratching to keep their heads above water, or they are retired individuals who rely on royalty checks to supplement their social security, or they are young couples who have made an investment.

* * * * *

MR. DOLE. In other words, they are not rich. Particularly if they are farmers, they are not rich. They are having trouble breaking even, under the programs now in operation. They are losing money. Now they are about to get another tax, of which they may not have been aware.

These are not the people who, at least in all the early considerations of this proposal and all the early press coverage of this proposal, were being singled out for the tax. All the focus was on big oil companies and foreign oil profits and first quarter profits of the big oil companies.

As I said before, now we are going to treat royalty owners just as we treat big oil companies. They are going to pay the same rates as Exxon, Gulf, and others.

They are not the profiteers, and I do not suggest that the others may be profiteers, but some are described as profiteers. They are not the ones I do not believe who were intended to be the victims of this tax.

* * * * *

MR. DOLE. On a barrel of stripper oil selling for $38, a royalty owner would typically receive $4.75 royalty payment. After the imposition of the windfall profit tax, the royalty owners will have to pay a $1.71 tax on this royalty. Thus, the royalty owner's payment per barrel will be slashed from $4.75 to $3.04 by this tax, a 36-percent drop in income. Again, that is a substantial drop in income.

We are not discussing and have not discussed over a period of months what it would really mean to the royalty owner. We tried in the conference. The distinguished chairman tried in conference and the Senator from Kansas tried in conference to ease the burden on the royalty owners. We did not succeed. We did not have the votes.

Now we have one opportunity, and maybe we cannot change the conference report, but it would seem to this Senator it would make a great deal of sense and offer some comfort to the hundreds of thousands of royalty owners if they understood that they had not been forgotten and were going to continue to try to find some way to ease the tax burden on royalty owners across the country.

We should have given thought maybe to a 50 or 100-barrell-per-day exemption for royalty owners. It would seem that even a 50-barrel-per-day exemption or smaller would exempt most royalty owners, especially the little royalty owners in whose situation most of us can generate a great deal of sympathy.

So it would seem to me, I say to the chairman, and I do not address these questions to him, only as we have address them to all my colleagues who are going to get

to vote tomorrow, if we are unsuccessful in addressing the royalty owners concerns in this bill, I hope that we could in some future legislation in the immediate future find some way to exempt small royalty owners, if not totally, to exempt 50-barrels per day, 25-barrels per day. That would catch the truly small royalty owners and I hope that in the next few months we will have an opportunity, in fact in the next few weeks, to address this very serious problem.

* * * * *

MR. DOLE. It would be my hope that tomorrow morning we could, at least in an effort to indicate to the royalty owners and independent producers in this country that we do have a concern, send this bill back to the Finance Committee for 5 days or for 10 days to try to figure out some way to address the real problem that exists.

So tomorrow morning, I say to those who are about to vote, take a look at the number of royalty owners they have in their States, whether it is 10,000 or 50,000 or the number they could have in their States before they vote on the motion to send this back to the Finance Committee for a specified number of days.

* * * * *

MR. LONG. Unfortunately, we did not have the language in the Senate bill we needed. In other words, we did not have the language in conference that would make it possible for us to do for the benefit of royalty owners what I would like to have done.

The Bentsen amendment was accepted in the Senate Chamber and the Bentsen amendment exempted independent producers from the windfall profit tax. It also would have exempted the royalty owners who held royalty interests in those independent wells—about one in seven royalty owners.

In conference, the House of Representatives would not agree to the complete exemption of the independents, but it did give them a better tax break so that they paid a lesser rate than did the major companies.

* * * * *

Mr. Long. Mr. President, that latter situation I regret. That involves most of the royalty owners. I would love to give them the 30-percent break or not tax them at all, but that was not in conference. It was not in the Senate bill; it was not in the House bill, and a point of order could be made from either side that we had no right to do it because it was not in conference.

I would be happy to support a provision on some other measure to try to do something about that. I wish it had been offered here in the Chamber. I would have been happy to have voted for it. Looking back on it, I wish I had offered it myself. I would have liked to have done more for royalty owners and give them a better break, and I assure the Senator from Kansas (Mr. Dole) and all others that as we look at future opportunities I will vote to support measures to give the royalty owners, particularly those beneath stripper wells, a better break than they are getting at this point. I wish we could do better about them, but it was not in conference.

Even if we voted down the conference report and went back to conference with the House of Representatives, it would still be subject to a point of order in both the Senate and the House of Representatives because neither the House bill nor the Senate bill provided the consideration for those royalty owners, the 85 percent of them who have their royalty beneath the major company wells.

So, it simply was not within the rules of the Senate and House and the rules of conference to give them a better break than the House bill or the Senate bill would have given them.

In the future I hope we can do something about it, but it will have to be separate legislation and it will have to be initiated in one House or the other before the bill goes to conference. It cannot be initiated once a bill has been referred to conference.